FOURTH QUARTER 2020

FORECAST REPORT 97

NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

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Cover: Faculty of Dentistry, University of Otago

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FORECAST 97

Prepared by the New Zealand Institute of Economic Research (Inc.) exclusively for Rider Levett Bucknall, Forecast is produced quarterly and provides detailed local construction market intelligence and knowledge.

CONSTRUCTION MARKET INTELLIGENCE

Forecast is supplemented by Rider Levett Bucknall's construction market intelligence publications: the International Report, regional (including the Oceania Report) and country specific reports.

KEY POINTS IN THIS ISSUE

Economic activity has been stronger than expected over the second half of 2020, led by a rebound in construction demand. The New Zealand economy is responding to a wide range of stimulus measures from the government and Reserve Bank. In particular, low interest rates and increased government spending are boosting housing demand, which in turn is encouraging new housing to be built.

Confidence continues to improve as uncertainty ebbs

Business confidence continues to improve, with the reduced uncertainty leading businesses to feel more confident about hiring and investment. The swift containment of community cases of COVID-19 has meant economic activity has been able to largely return to normal, except for the effects of continued border restrictions. However, the move of Auckland to Alert Level 3 in mid-February in response to the discovery of community cases highlights how quickly things can change.

Record low interest rates boost demand for housing

The continued decline in mortgage rates is continuing to fuel demand for housing, with house prices increasing strongly across the regions. This is reflected in the continued strong growth in new lending on housing, in contrast to the continued contraction in consumer credit.

Construction most buoyant sector on increased demand

A strong rebound in construction demand has driven a sharp turnaround in confidence in the sector. The NZIER Quarterly Survey of Business Opinion shows the construction sector has turned from the most pessimistic sector surveyed in the first half of 2020, to being the most optimistic in the second half of 2020.

Potential for further OCR cuts fades

Stronger than expected economic activity and signs of capacity pressures building in some parts of the economy has reduced expectations of any further OCR decreases. We now expect the Reserve Bank to keep the OCR on hold through to 2023.

Future outlook

Despite the potential for continued uncertainty related to long term COVID management and the speed with which the situation can change, the property and construction sector's longer-term outlook is positive due to:

- A low-interest rate environment
- RMA reforms
- Climate change adaptation,
- Extensive infrastructure programs

The University of Auckland Faculty of Engineering, Auckland

BUILDING ACTIVITY TRENDS

Prospects for the building sector have improved markedly over the second half of 2020. A strong recovery in the pipeline of construction work has seen the building sector turn from the most pessimistic to the most buoyant of the sectors surveyed. The NZIER *Quarterly Survey of Business Opinion* shows a net 6 per cent of building sector firms expect an improvement in general economic conditions over the coming months, in contrast to the net 16 per cent of all firms surveyed expecting a deterioration in the economy.

The decisive outcome of the general election in October and containment of community transmission of COVID-19 has reduced uncertainty about the outlook for businesses. Except for the effects of border restrictions which is having a severe impact on some parts of the economy such as tourism, economic activity is largely returning to normal. Reduced uncertainty about the economic outlook led businesses to feel more positive about hiring and investing. However, the move of Auckland to Alert Level 3 in mid-February in response to the discovery of community cases highlights how quickly things can change.

The recovery in investment intentions for buildings supports the increased pipeline of construction work. The NZIER QSBO measure of architects' work in their own office points to a growing pipeline of construction across residential, commercial and government work. Increased government spending on infrastructure is supporting increased construction demand, while the continued rise in house prices is also encouraging residential construction.

These activity indicators are in line with the continued increase in consent issuance, particularly for dwellings. This increase in residential construction demand reflects the effects of strong population growth in recent years, with record-low mortgage rates also supporting strong demand for housing. Strong demand for medium-density housing such as townhouses continues to drive the growth in residential construction demand. Meanwhile, demand for high-density housing such as apartments is starting to pick up again after a decline over much of 2020. We expect the continued low interest rate environment will support demand for residential construction over the coming years, with demand for multi-unit dwellings likely to be stronger given the shortage of centrally located land.

The government announced in February that the Resource Management Act 1991 (RMA) will be repealed and replaced with the Natural and Built Environments Act (NBA), Strategic Planning Act (SPA) and the Climate Change Adaptation Act (CAA). The aim of this reform is to enable more effective housing and urban development through the coordination of infrastructure with land use and development within the natural environmental limits. With the process for reform taking place over 2021 and 2022 and details yet to be finalised, any potential impact on construction will be some time away.

Demand for construction has been particularly strong in Auckland, reflecting the region's concentration of migration-led population growth over the past decade. The annual number of dwelling consents issued in Auckland reached new record highs in the 2020 year, despite the disruptions of the Alert Level lockdowns. Dwelling consent issuance in Canterbury has also been rising, in contrast to the easing in Wellington and Waikato. With house prices increasing strongly across the regions, we expect this will support a broad-based increase in demand for residential construction.

BUILDING ACTIVITY OUTLOOK

The strong rebound in construction demand has seen a re-emergence in capacity pressures in the sector. Reduced freight capacity is causing supply chain disruptions for building materials. Building sector firms are also starting to experience labour shortages, particularly for skilled labour. The December quarter labour market data showed a strong increase in construction-related employment driving the recovery in the labour market.

Given the strong pipeline of construction work, we expect demand for workers in the construction sector will remain robust over the coming year. December quarter Consumer Price Index (CPI) shows a lift in residential construction cost inflation. We expect continued capacity pressures in the construction sector will drive a pick up in construction cost inflation over 2021. However, the potential for further lockdowns in the economy should further COVID-19 community cases eventuate, presents some downside risk to the construction outlook over the remainder of 2021.

ECONOMIC BACKDROP

The containment of community transmission of COVID-19 in New Zealand has reduced uncertainty and allowed activity to largely return to normal, barring the effects of continued border restrictions. The rebound in demand has been stronger than expected, as the New Zealand economy responds to the stimulus from the government and the Reserve Bank. The recovery in housing market activity has been particularly sharp, largely reflecting the effects of record low mortgage rates and improvement in employment prospects.

However, the recovery remains uneven. As reflected in the December quarter employment data, the strong growth in construction activity contrasts with reduced demand in the media and tourism industries over the past year. Retail spending data also shows the unevenness of demand, with spending on accommodation and travel still at low levels. With the government indicating that borders will largely remain closed for 2021, we expect tourism activity to remain weak over the coming year. Beyond that, the pace of a COVID-19 vaccine rollout around the world will be a key influence on the extent of recovery in tourism.

The continued border restrictions have also meant net migration inflows remain very low, with annual net inflows easing below 50,000 for the year to November 2020 – well below the circa-68,000 in net inflows a year ago and the peak of around 94,000 in March 2020. Although the government has relaxed some rules around who can move to New Zealand under the critical worker categories, net migration inflows are likely to remain weak over 2021.

Nonetheless, strong migration-led population growth over recent years, along with record low mortgage rates, is driving the strong rebound in housing demand. Tight housing supply is supporting a surge in house prices, which in turn is boosting demand for residential construction. Strong housing market activity is also driving a large lift in retail spending on furniture, electronics and hardware as households furnish their new homes.

Global demand for New Zealand exports has been mixed, with a strong increase in fruit exports over the past year offsetting the decline in forestry exports. With the COVID-19 outbreak causing disruptions in the major economies around the world, weaker investment is weighing on demand for forestry. We expect global demand for New Zealand exports will be concentrated on primary commodities over the coming year, reflecting the shift towards spending on necessities.

INTEREST AND EXCHANGE RATES

Over the past year, the Reserve Bank has put in place measures to keep interest rates low to encourage spending and investment. These stimulus measures include cutting the OCR, introducing quantitative easing through its $100 billion Large Scale Asset Purchase (LSAP) Programme and implementing a Funding for Lending Programme (FLP) to enable banks to access funding at near the OCR to encourage them to pass on lower borrowing costs to their customers.

The New Zealand economy has responded to these measures with a strong rebound in activity. Demand for assets such as housing and shares have been particularly strong in the low-interest rate environment. With the economy proving to be more resilient than initially expected during the height of the COVID-19 outbreak in New Zealand, expectations a negative OCR will be introduced has faded in recent months.

The improving outlook for the New Zealand economy and reduced expectations of further cuts in the OCR has supported an appreciation in the New Zealand dollar, with the NZD/USD rising above 72 cents. We expect that as conditions in the other major economies improve, the NZD will ease to around 65 cents over 2021.

BUILDING INVESTMENT

Consent issuance for residential construction remains very strong, while that for non-residential construction has started to recover. Banks' continued caution towards lending for commercial property is weighing on private sector non-residential construction demand. However, demand for industrial buildings is robust, reflecting the increased focus on supply chain management given changes in freight capacity and growing shift towards online shopping.

BUILDING CONSENTS

Non-residential consent issuance is at higher levels than a year ago, but on an annual basis it has yet to make up for the sharp declines experienced over the lockdown periods. Businesses are starting to feel more positive about investment in buildings, and we expect that will underpin a further increase in non-residential consent issuance over 2021.

Building consents by sector

Demand for storage buildings led the demand for non-residential construction over the past year. The Business NZ BNZ Performance of Manufacturing (PMI) survey showed a strong rebound in manufacturing activity in January. We expect increased manufacturing output will underpin robust demand for industrial buildings over the coming year.

Weekly light vehicle traffic flows rose back close to pre-lockdown levels in recent months, suggesting people headed back to the office and largely resumed normal activities as New Zealand moved down the alert levels. However, there are signs office workers continued to work from home for at least some days of the week even as lockdown restrictions were relaxed. This increased flexibility of where people can work will likely weigh on demand for office space in the city centres, even with the increase in white collar jobs more recently.

Meanwhile, the severe impact of continued border restrictions on tourism activity is reducing demand for the construction of new accommodation and retail outlets. With the government indicating borders will likely remain closed until 2022, we expect non-residential construction demand in these sectors will remain weak over the coming year. Although the recovery in consumer confidence points to an improving outlook for retail spending, the growing shift towards online shopping will weigh on demand for bricks and mortar shops over the longer term.

Building consents by region

Although non-residential consent issuance in Auckland increased in recent months, on an annual basis it is much lower than year ago levels. Over the past year, the decline in Auckland non-residential consent issuance was driven by reduced demand for retail outlets and office buildings. Auckland demand for health facilities and social and education buildings also declined over the past year. The marked increase in office vacancy in the Auckland CBD over 2020 should weigh on construction demand for office buildings over the coming years. Uncertainty over the potential for future lockdowns may also weigh on business confidence and reduce commercial construction demand.

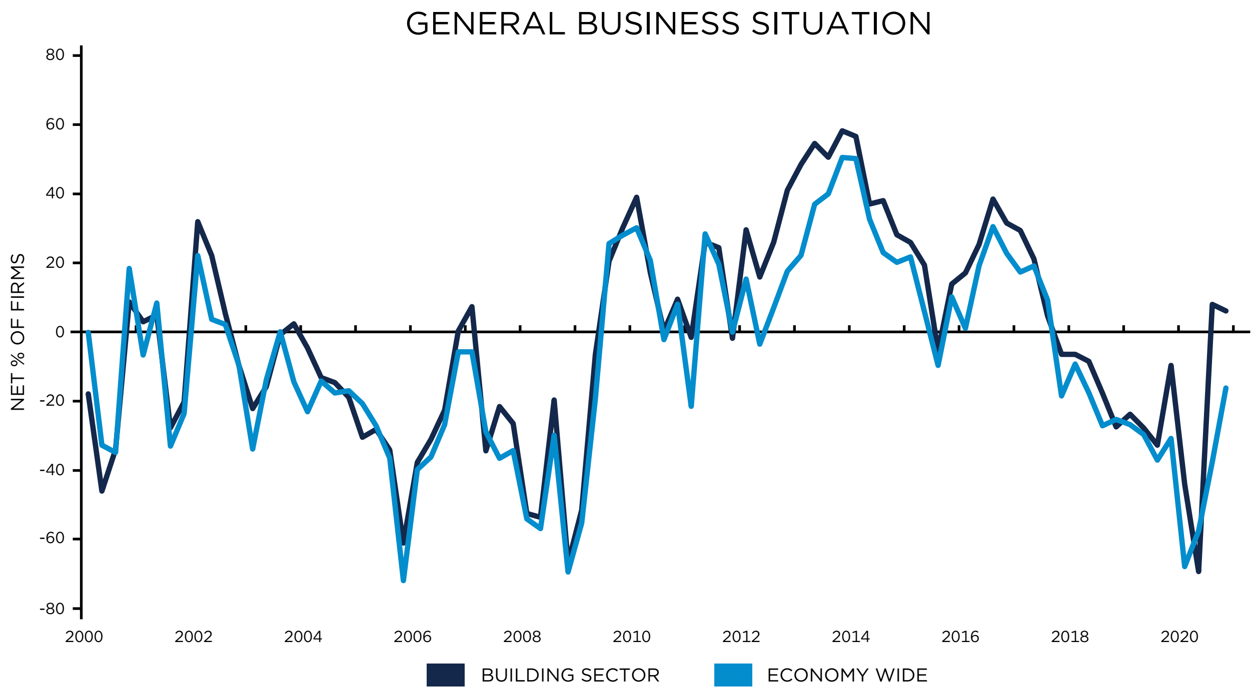
The increase in office vacancy in Wellington has been more muted, reflecting the dominance of the public sector which has meant the region has been more sheltered from the effects of the COVID-19 outbreak. Non-residential consent issuance for office buildings in Wellington increased strongly over the past year. In contrast, demand for health facilities and social buildings declined.

Non-residential consent issuance in Canterbury fell sharply over the past year, driven by a broad-based decline across most sectors including accommodation, education and social buildings, and storage buildings.

FIGURE 1

Building sector now the most buoyant sector in NZ

Net % of firms

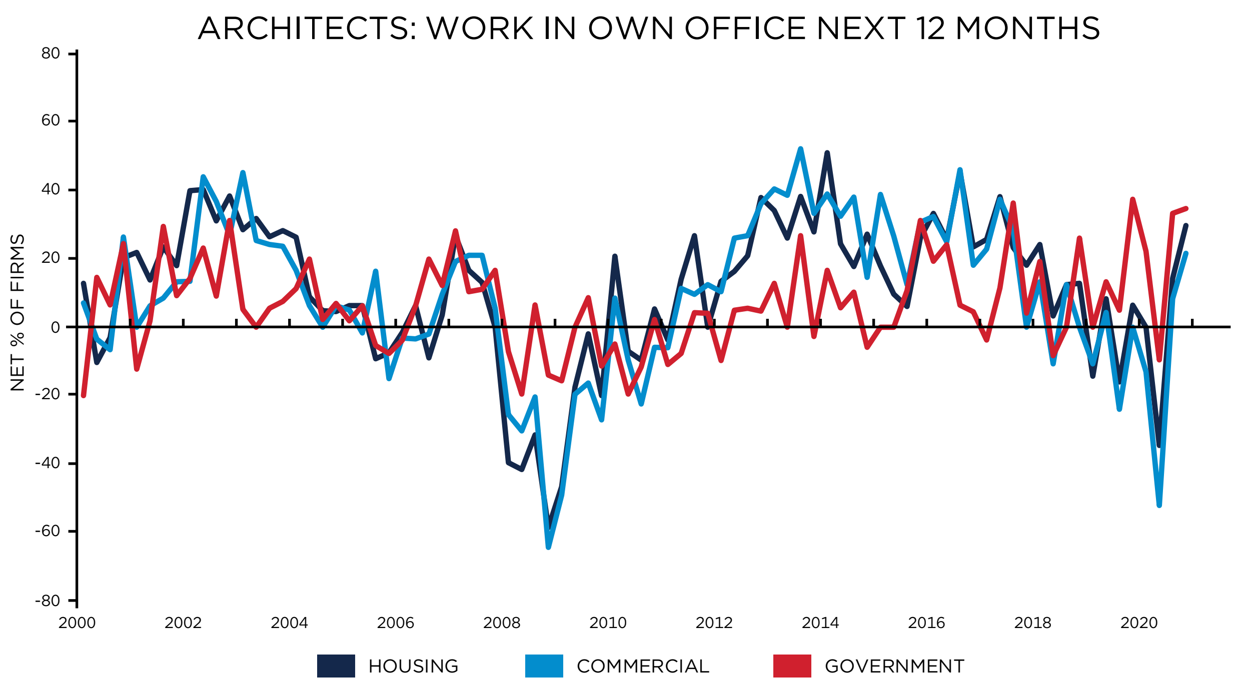


Source: NZIER

FIGURE 2

Strong pipeline of construction work

Net % of firms

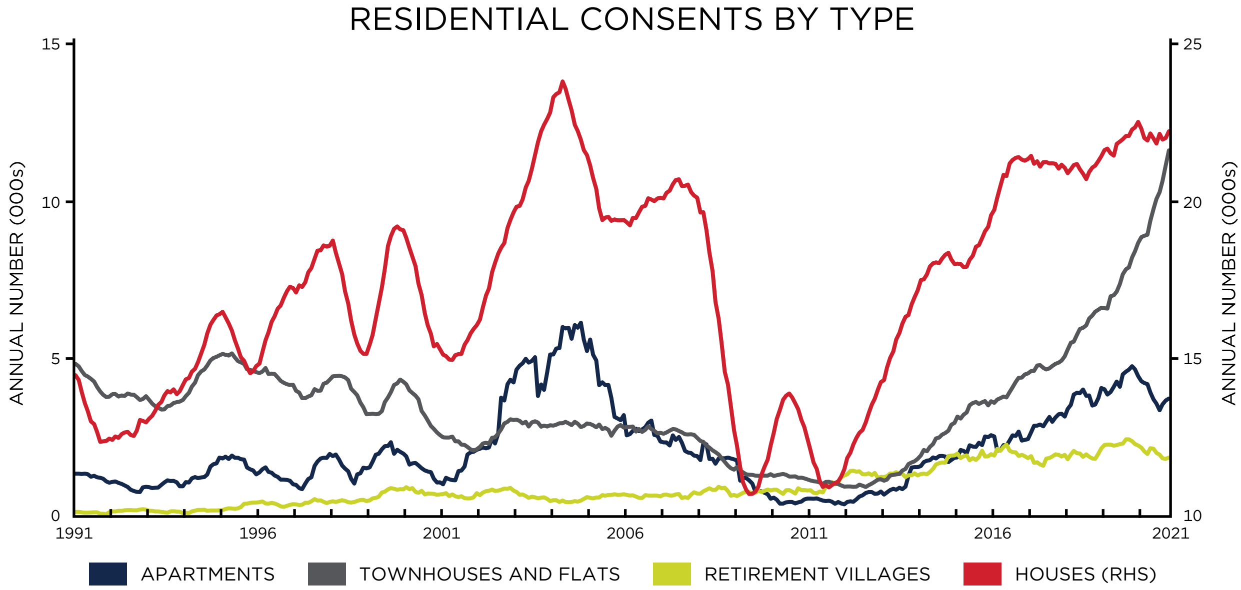


Source: NZIER

FIGURE 3

Strong demand for medium-density housing

Annual number of consents

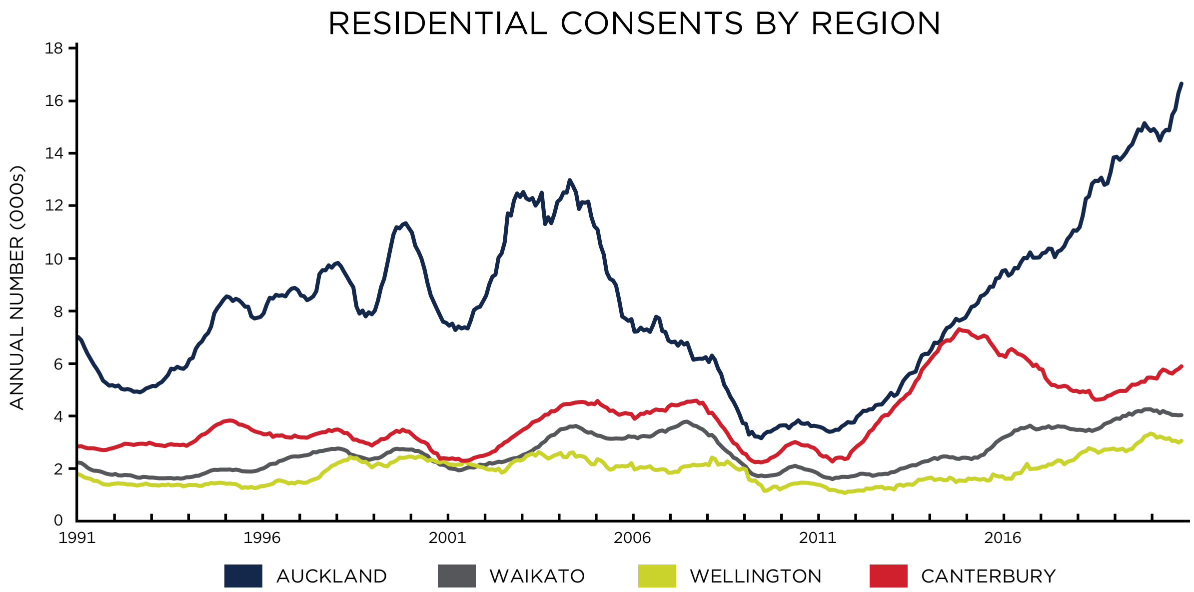


Source: Stats NZ

FIGURE 4

Auckland leading the strength in construction demand

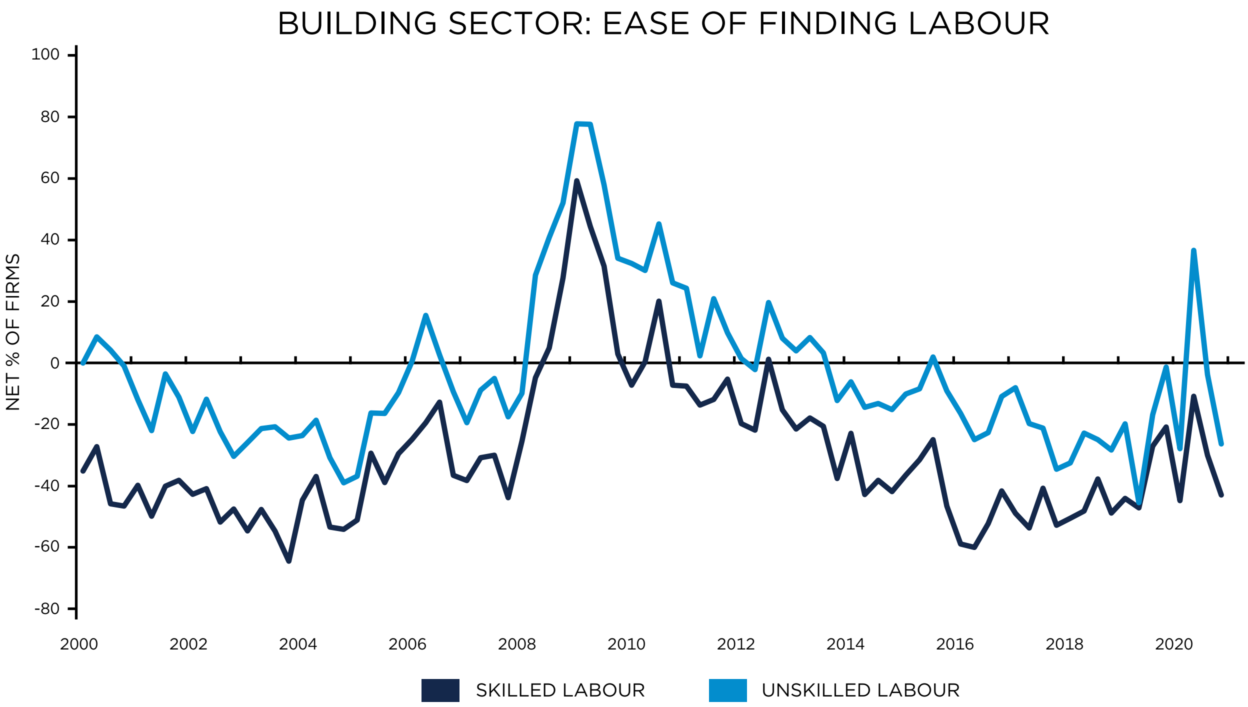
Annual number of consents



Source: Stats NZ

FIGURE 5

Labour shortages re-emerging in the building sector

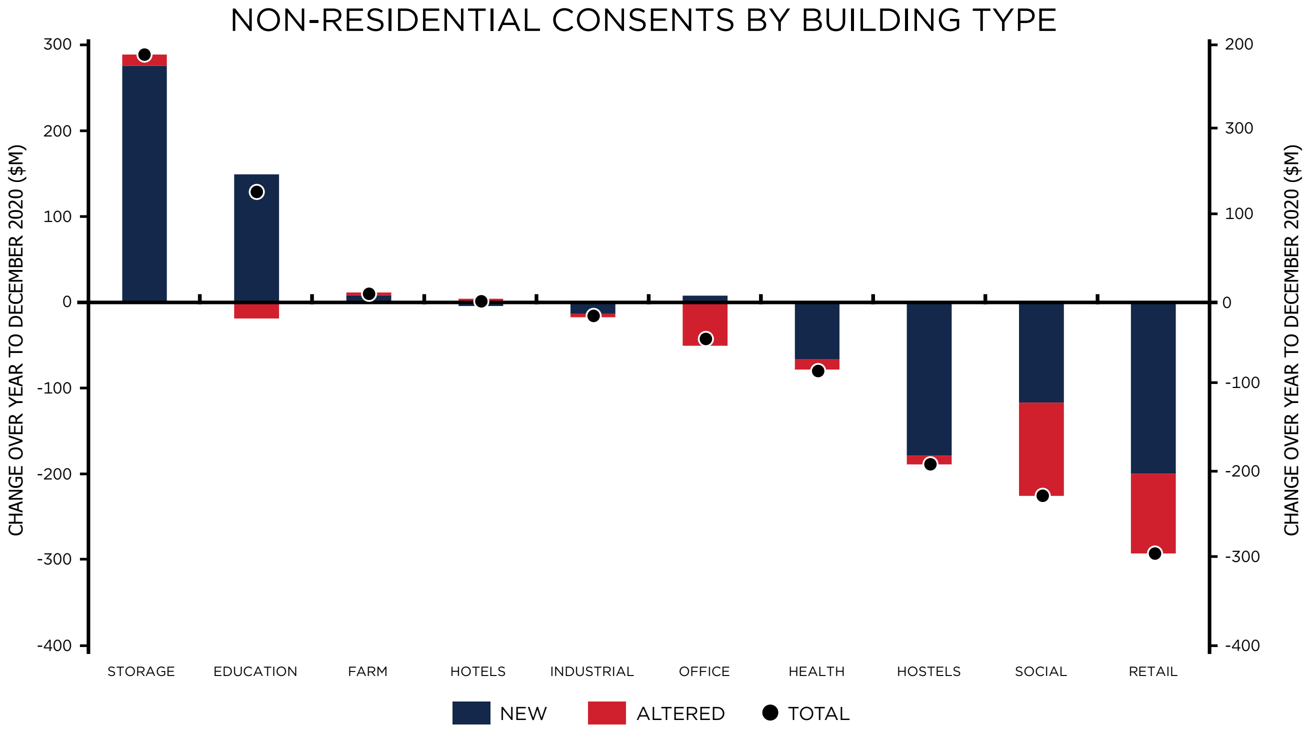


Source: NZIER

FIGURE 6

Growing demand for storage buildings

Change over year to December 2020



Source: Statistics NZ, NZIER

TABLE 1

Non-residential building consents by region and sector

$m of consents for the year ending December 2020; red colour shading for decline in consents from previous year

	SECTOR									
REGION	HOSTELS, PRISONS ETC	ACCOMODATION	HEALTH	EDUCATION	SOCIAL, CULTURAL, RELIGIOUS	RETAIL	OFFICE	STORAGE	INDUSTRIAL	FARM
NORTHLAND	0.0	4.3	25.0	75.3	17.1	17.1	17.5	12.4	16.5	15.8
AUCKLAND	66.6	315.8	152.7	438.0	143.5	296.0	356.3	579.6	243.0	28.2
WAIKATO	135.7	3.6	25.9	141.0	26.1	59.5	66.8	92.6	78.5	97.0
BAY OF PLENTY	10.4	20.0	15.6	58.9	40.8	62.2	29.1	53.6	73.2	11.5
GISBORNE	1.7	0.4	3.2	17.3	9.7	12.9	2.6	0.8	6.4	2.6
HAWKE'S BAY	1.3	2.0	48.5	22.5	5.3	33.7	23.5	43.0	46.7	21.9
TARANAKI	1.0	0.1	7.6	15.7	5.7	8.5	12.6	6.7	17.3	13.2
MANAWATU-WANGANUI	8.9	4.7	9.6	50.2	37.5	9.1	21.8	80.8	45.7	13.8
WELLINGTON	2.5	11.2	33.0	90.2	129.4	53.1	295.9	80.4	47.6	9.5
NELSON	0.3	0.3	7.3	5.3	3.1	5.1	2.9	3.0	5.6	0.3
TASMAN	0.0	1.2	4.5	10.0	3.8	18.9	3.0	5.7	13.1	2.4
MARLBOROUGH	0.3	3.6	0.0	4.8	26.9	3.3	0.4	4.7	25.1	3.9
WEST COAST	0.0	0.2	1.1	11.8	0.8	5.4	1.9	1.3	2.3	3.3
CANTERBURY	2.3	38.7	148.5	125.5	109.0	82.4	58.1	107.1	100.5	28.2
OTAGO	6.8	114.4	43.9	101.7	26.6	29.3	32.9	39.1	32.8	18.3
SOUTHLAND	0.8	25.4	1.4	57.9	7.2	66.5	34.7	44.3	22.4	19.7

Source: Statistics NZ, NZIER


University of Waikato, Tauranga

BUILDING COSTS

The Capital Goods Price Index for Non-Residential Buildings (CGPI-NRB) (the Index) is an official measure of cost movements in the sector. The Index excludes GST. We use the Index as an indicator of cost escalation.

The Index is a national average across all building types. We therefore advise caution in applying the increase in the CGPI-NRB as an indicator of cost escalation for specific projects.

The Rider Levett Bucknall Third Quarter 2020 Oceania Report provides local regional comment and tender price relativity between the main New Zealand and Australian centres. This publication is available at www.rlb.com or on request from any Rider Levett Bucknall office.

Non-residential construction cost escalation continued to ease in the September 2020 quarter, reflecting the weaker construction activity over the first half of 2020.

The rebound in construction demand over the second half of 2020 has seen a re-emergence in capacity pressures in the sector.

Construction materials firms surveyed in the NZIER QSBO showed a sharp increase in cost pressures over the second half of 2020, with a net 39 per cent of firms reporting higher costs in the December quarter. Furthermore, a net 58 per cent expect further price increases in the next quarter. Regional material suppliers highlight the substantial price increases seen in primary construction materials such as steel and timber. This reflected the effects of supply chain disruptions as a result of reduced freight capacity as a result of the COVID-19 outbreak globally.

The strong rebound in construction demand has led to high demand for contractors in the sector, with building sector firms reporting increased difficulty in finding labour. These labour shortages should underpin a pick-up in wage growth over the coming years. Increased statutory holidays and sick leave provisions will also add to labour costs.

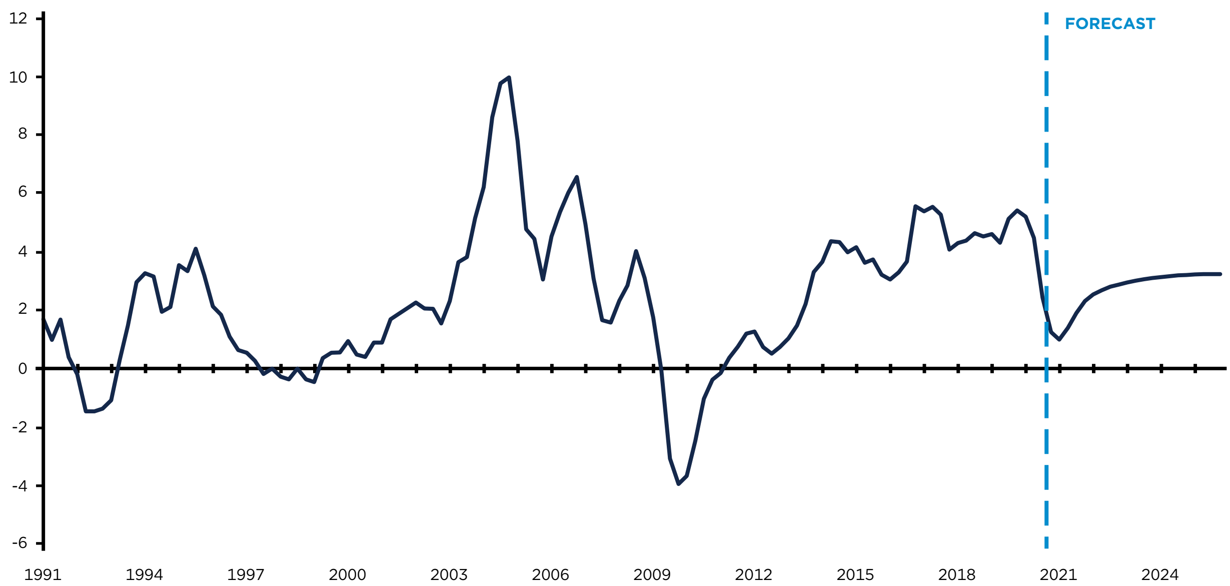
Meanwhile, measures aimed at lowering carbon emissions will likely boost initial capital costs of construction, balanced against cost savings over the operational life of the buildings. The net impact on development costs will depend largely on the measures specifically implemented for each development.

We expect these factors will drive a lift in construction cost escalation over 2021, with annual cost escalation to rise from a trough of 1 per cent in March 2021 to 2.3 per cent by the end of this year. Beyond that, we forecast a more modest increase in cost escalation towards 3 per cent by 2023.

FIGURE 7

Non-residential building cost escalation

CGPI-NRB index, annual % change



Source: Statistics NZ, NZIER forecasts

TABLE 2

Non-residential building cost index

YEAR	QUARTER	INDEX	QUARTERLY % CHANGE	ANNUAL % CHANGE
2016	MARCH	1519	0.8	3.1
	JUNE	1533	0.9	3.3
	SEPTEMBER	1553	1.3	3.7
	DECEMBER	1591	2.4	5.6
2017	MARCH	1601	0.6	5.4
	JUNE	1618	1.1	5.5
	SEPTEMBER	1635	1.1	5.3
	DECEMBER	1656	1.3	4.1
2018	MARCH	1670	0.8	4.3
	JUNE	1689	1.1	4.4
	SEPTEMBER	1711	1.3	4.6
	DECEMBER	1731	1.2	4.5
2019	MARCH	1747	0.9	4.6
	JUNE	1762	0.9	4.3
	SEPTEMBER	1799	2.1	5.1
	DECEMBER	1825	1.4	5.4
2020	MARCH	1838	0.7	5.2
	JUNE	1841	0.2	4.5
	SEPTEMBER	1843	0.1	2.4
	DECEMBER	1848	0.3	1.3
2021	MARCH	1856	0.5	1.0
	JUNE	1867	0.6	1.4
	SEPTEMBER	1878	0.6	1.9
	DECEMBER	1891	0.7	2.3
2022	MARCH	1904	0.7	2.5
	JUNE	1917	0.7	2.7
	SEPTEMBER	1931	0.7	2.8
	DECEMBER	1945	0.7	2.9
2023	MARCH	1960	0.8	3.0
	JUNE	1975	0.8	3.0
	SEPTEMBER	1990	0.8	3.1
	DECEMBER	2006	0.8	3.1
2024	MARCH	2021	0.8	3.1
	JUNE	2037	0.8	3.2
	SEPTEMBER	2054	0.8	3.2
	DECEMBER	2070	0.8	3.2
2025	MARCH	2087	0.8	3.2
	JUNE	2103	0.8	3.2
	SEPTEMBER	2120	0.8	3.2
	DECEMBER	2137	0.8	3.2

Notes: The current and forecast CGPI-NRB is a national average, which does not differentiate between regions or building types. We therefore advise caution in applying the increase in the CGPI-NRB as a measure of cost escalation for specific building projects.

Source: Statistics NZ, NZIER forecasts

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